

## Czech Republic: Inflation slows down further

As expected, inflation slowed down slightly to 1.7% mainly on the back of lower food prices. And the central bank might even appreciate this now as the market will stop betting on further rate hikes



**1.7% YoY** March inflation

As expected

### Inflation slowdown driven by food

March inflation remained below the Czech National Bank's target of 2% and slowed to 1.7% compared to 1.8% in February.

In month-on-month terms, prices fell slightly (-0.1%). The year-on-year slowdown in inflation compared to February was driven mainly by lower food prices, which declined in MoM terms (-0.6 MoM) and its YoY dynamics slowed down from 2.3% to 1.9% YoY. Fuel prices also declined slightly

(-0.8% in MoM terms and -2.0 %YoY).

## The structure of inflation

	YoY (%)	Cont (ppt)	MoM (%)	Cont (ppt)	YoY( t-1) (%)	Cont (ppt)
<b>Total</b>	<b>1.7</b>	<b>1.7</b>	<b>-0.1</b>	<b>-0.1</b>	<b>1.8</b>	<b>1.8</b>
Food and non-alcoholic beverages	1.9	0.3	-0.6	-0.1	2.3	0.4
Alcoholic beverages, tobacco	2	0.2	0.4	0.0	2.3	0.2
Clothing and footwear	-0.2	0.0	0.9	0.0	-0.1	0.0
Housing, water, energy, fuel	2.3	0.6	0.1	0.0	2.3	0.6
Furnishings, households equip.	1	0.1	0.4	0.0	1.3	0.1
Health	3.8	0.1	0.6	0.0	3.8	0.1
Transport	1.1	0.1	-0.2	0.0	1.1	0.1
Post and telecommunication	-2.4	-0.1	-0.1	0.0	-2.3	-0.1
Recreation and culture	0.7	0.1	-1.2	-0.1	0.4	0.0
Education	1.5	0.0	0	0.0	1.5	0.0
Restaurants and hotels	3.4	0.2	0.4	0.0	3.4	0.2
Miscellaneous goods and services	2.1	0.1	0.4	0.0	1.4	0.1

Source: CZSO, ING Bank

## Prices of services accelerated in March

Inflation reached its peak in October last year at 2.9% YoY but has been slowing down since then. This is due to the effect of the comparative basis and a stronger koruna. At the turn of 2016/2017, prices started to accelerate due to a faster increase in food and restaurant prices due to the introduction of online sales registration.

The slowdown of food prices has a significant role in the slowdown of inflation too. Their contribution to year-on-year price growth was 1.3ppt in October 2017 due to their 7.8% YoY growth, and now they contribute just 0.3ppt in March. As such, one percentage point of weaker inflation is only due to the slowdown in annual food price developments.

However, from the point of view of the central bank, this is not a problem as it is a supply factor. On the other hand, prices of services in March slightly accelerated to 2.5% YoY after 2.4% in February, and according to our estimates, core inflation in the CNB definition most likely remained stable at 1.7%.

## Labour market still positive

Moreover, today's figures confirm that labour market is still developing favourably. The March share of unemployed people further declined from February's 3.7% to 3.5%. The lower unemployment rate is driven by seasonal factors such as warmer weather in March, but also by favourable economic developments such as increasing firms' demand for workers.

Thus, job vacancies have increased further and already exceeds 253 thousand – a new historical record. This year, the economy will get into the situation, where the number of job vacancies will exceed the number of job seekers. From this development, long-term unemployed and workers with lower qualification are benefiting, as the unemployment rate in these subgroups is decelerating at most rapid pace.

## Convenient for the central bank?

The Czech National Bank may even appreciate the slightly below the target inflation now, as markets will stop betting on further rate hikes and won't push the CZK to stronger levels. The economy will not be "cooled" by a stronger crown, which will eventually allow the CNB to tighten monetary policy by rates. Despite lower inflation, we are still counting with the CNB hikes in the second half of this year.

Also, the CNB does not follow current inflation, but inflation in the monetary policy horizon which is one to one-and-half year. And thanks to the current development of the overheated labour market and accelerating wage dynamics, inflationary pressures in the monetary policy horizon are mounting.

So thanks to the robust wage growth, current inflation below the target is not any negative news for the CNB.